



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

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**MEMORANDUM**

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**SUBJECT:** Interim Audit Report – Minnesota Democratic-Farmer-Labor Party  
(LRA 835)

**I. INTRODUCTION**

The Office of the General Counsel has reviewed the proposed Interim Audit Report ("LAR") on the Minnesota Democratic-Farmer-Labor Party ("MDFLP").<sup>1</sup> Our comments address issues pertaining to the MDFLP's payroll account as presented in Finding 1 (Misstatement of Financial Activity) and Finding 2 (Over-funding of Federal Accounts by Non-Federal Accounts). We concur with any findings not specifically discussed in this memorandum. If you have any questions, please contact Danita C. Lee, the attorney assigned to this audit.

As background, the MDFLP established a separate payroll account to ease its administrative payroll processing burden. The payroll account was funded by transfers from the MDFLP's Federal and non-Federal operating accounts. The MDFLP made Federal and non-Federal payroll disbursements for salary and taxes from the payroll account. The MDFLP did not allocate the salaries of any of its employees but rather paid

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<sup>1</sup> We recommend that the Commission consider this document in Executive Session because the Commission may eventually decide to pursue an investigation of matters contained in the proposed Report. 11 C.F.R. §§ 2.4(a) and (b)(6).

employee salaries as either 100% Federal or 100% non-Federal. The MDFLP did not disclose any non-Federal activity associated with the payroll account. The MDFLP states that the payroll account was a "pass-through" account and not either a Federal or non-Federal account and, therefore, it was not required to disclose any non-Federal activity.

## **II. USE OF PAYROLL ACCOUNT (Findings 1 and 2)**

Finding 1 addresses the MDFLP's failure to disclose non-Federal activity associated with the payroll account. The proposed IAR concludes that the payroll account is a Federal account from which all activity, including non-Federal activity, is reportable to the Commission. The Commission recently considered similar facts when it addressed the Audit Division Recommendation Memorandum on the Georgia Federal Elections Committee ("Georgia"). In Georgia, the Commission considered the permissibility of a payroll escrow account and whether the Georgia committee was required to disclose non-Federal activity associated with the payroll escrow account. The Georgia committee had established a separate account from which to make its Federal and non-Federal payroll disbursements. The Georgia committee transferred funds from its Federal and non-Federal operating accounts to a payroll account to enable its payroll vendor to pay the salaries of the committee's Federal, non-Federal, and allocable employees. The Georgia committee considered the payroll account an "escrow account" because it was used exclusively by its payroll vendor to draw funds to pay salaries and payroll taxes. The Georgia committee asserted that the payroll escrow account was neither a Federal account nor an allocation account and thus stated that it was not required to report the account's non-Federal activity. The Commission concluded that Georgia was "not required to further amend its reports in relation to the transactions involving the payroll escrow account." Audit Division Recommendation Memorandum on the Georgia Federal Elections Committee, Motion #4 on A07-14 (Georgia FEC) ("Consensus" Motion) v.2.

The language of the motion approved by the Commission in the Georgia audit, however, did not state the reasons for the Commission's conclusion, and different Commissioners advanced different rationales – some of them more than one rationale. Accordingly, we are unsure whether the payroll account in this case is legally distinguishable from the payroll escrow account in Georgia. Given the uncertainty in how the Georgia audit should be interpreted, we recommend that the Audit Division raise this issue in the cover memorandum that forwards this audit report to the Commission.

In Georgia, some Commissioners indicated agreement with the audited committee's argument that a payroll escrow account is neither Federal nor non-Federal. These Commissioners, as we understand it, specifically rejected the argument we set forth in our legal analysis memorandum that the payroll escrow account there was the "functional equivalent" of an allocation account established pursuant to 11 C.F.R. § 106.7(f), and that all of the account's activity was therefore reportable under 11 C.F.R. § 104.17(b). If this was the conclusion reached in Georgia, we are unable to perceive a legally significant difference between the account there and the account here. Like the

account in Georgia, the account here appears to have been set up as a type of escrow account used only for the payment of salary and payroll taxes. It does not appear to have been any more of an allocation account than the account in Georgia. It is true, as the Audit Division pointed out, that the account in Georgia was established to accommodate a payroll processing vendor that represented it could not handle payroll from multiple bank accounts for a single client, whereas this account was administered by the committee itself and appears to have been established solely for the committee's administrative convenience. But the written conclusion in Georgia was not limited by the facts regarding the payroll vendor. If the Commission's action in Georgia means that committees conducting both Federal and non-Federal activity may establish "payroll escrow" accounts of this type that are neither Federal nor non-Federal, and that any 100% non-Federal payroll that flows through this account need not be reported, we do not see that the committee's motive for establishing such an account makes any difference.

On the other hand, if the Commission's action in Georgia was an act of administrative discretion driven by the fact that there was no "overfunding" of Federal or allocable payroll in that case, different facts are present here.

In our comments after the Georgia audit hearing, we noted that

[I]n the circumstances where the Commission has permitted the mixing of federal and non-federal money in the same account, committees have been required to disclose all of the activity in that account, including the non-federal portion. See 11 C.F.R. § 104.17(b) . . . The purpose of these requirements is to "allow the Commission to track the flow of non-federal funds into federal accounts," and "ensure that the use of such funds is strictly limited to payment for the non-federal share of allocable activities." Explanation and Justification for Methods of Allocation Between Federal and Nonfederal Accounts, 55 Fed. Reg. 26,058, 26,065-66 (June 26, 1990).

Memorandum to Joseph F. Stoltz, July 1, 2010, at 3. We noted that the Commission might wish to determine that because the Audit Division was satisfied that non-Federal funds in the Georgia payroll account had been strictly limited to payment of 100% non-Federal salaries and taxes and the non-Federal share of allocable salaries and taxes, then, as a matter of administrative discretion, there was no need to require the Georgia committee to amend its reports to disclose 100% non-Federal payroll. And, indeed, a number of Commissioners noted the lack of "overfunding" at various points in the Commission's consideration of Georgia. One Commissioner noted that she believed the Georgia committee did not need to make any additional disclosures, in part, because Georgia's payroll account transactions did not involve any non-Federal subsidies. During the audit oral hearing, another Commissioner indicated that he did not have any concerns with Georgia's payroll account because there was no overfunding present. Finally, another Commissioner indicated that since there was no evidence of circumvention involving non-Federal money funding Federal activity and because the auditors

confirmed there was no overfunding, he considered Georgia's payroll account permissible. He also distinguished "pass-through" accounts from accounts where there is a potential of soft money flowing into Federal accounts and funding Federal activity.

Different facts, however, are at issue here. In contrast to Georgia, where there was no overfunding, the proposed IAR here indicates that non-Federal transfers to the payroll account paid for \$86,363 of Federal payroll – slightly less than one-third of the total overfunding addressed in Finding 2, the overfunding finding. If the Commission's determination in Georgia was an act of administrative discretion based on the documented lack of any overfunding in that case, then the facts suggest that the cases are distinguishable and MDFLP should be required to report the non-Federal payroll from this account.

By clarifying the rationale for its action in Georgia, the Commission can resolve the issue in this case. The Audit Division can assist the Commission by raising the issue in the cover memorandum that forwards the proposed IAR to the Commission.

### **III. HEALTH AND RETIREMENT BENEFITS EXPENSES PAID FROM FEDERAL ACCOUNT (Finding 1)**

Although the MDFLP paid its employee salaries and taxes from its payroll account, the MDFLP paid from a Federal "administrative" account employee health insurance and retirement benefits for both its 100% Federal and 100% non-Federal employees. However, the MDFLP did not report the 100% non-Federal expenses. The auditors are unsure how MDFLP financed these payments because the state of the MDFLP's records is such that it is not possible to match specific transfers of non-Federal funds to the "administrative" account with any specific disbursements from that account.<sup>2</sup> It is clear that the MDFLP transferred some non-Federal funds to this account, but because the MDFLP paid allocable expenses from this account that, in and of itself, is not surprising.

Thus, MDFLP might have used 100% Federal funds to pay these particular 100% non-Federal expenses. This is always permissible. Nevertheless, when a committee chooses to use Federal funds to pay a non-Federal expense, it must still report the disbursement of those funds. Regardless of the Commission's rationale in Georgia for not requiring the reporting of non-Federal payroll from a "payroll escrow" account, we do not understand that decision to extend to clearly defined Federal accounts such as the MDFLP's Federal "administrative" account – even if the financial activity is for employee salaries or benefits. All disbursements from a Federal account must be reported. See 2 U.S.C. §§434(b)(2) and (4). If the MDFLP paid these expenses with 100% Federal funds, it should have itemized the payments on Schedule B as operating expenses (assuming the payments exceeded the itemization threshold).

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<sup>2</sup> The Audit Division did not include a recordkeeping finding because the activity did not breach the materiality thresholds for recordkeeping.

Alternatively, MDFLP might have intended to pay these non-Federal expenses using non-Federal funds that were transferred from the non-Federal account following the same procedure as it used for payment of allocable expenses but as if the payment was "allocated" 100% non-Federal and 0% Federal. If this were the case, then the transactions were not in compliance with 11 C.F.R. § 106.7(f) because "State, district and local party committees may transfer funds from their non-Federal to their Federal accounts or to an allocation account *solely* to meet *allocable* expenses under this section[.]" 11 C.F.R. § 106.7(f) (emphasis added). An expense payable with 100% non-Federal funds – and the proposed IAR does not dispute that the employee insurance and benefits at issue were 100 % non-Federal – is, by definition, not allocable, and thus transfers of non-Federal funds to a Federal account and payment of the expense thereafter by the Federal account are not permissible. Despite the impermissibility of such transfers in Federal accounts, committees are required to disclose all receipts and disbursements. We raised the issue with the Reports Analysis Division ("RAD") of how should MDFLP report the receipts and disbursements if MDFLP used non-Federal transfers to finance the non-Federal salary benefits, and RAD recommends that committees disclose the transfers as receipts of activity on Schedule A, Line 17 (Other Receipts) and include memo entries referencing the original disbursements.

The Committee should be given the opportunity in response to the IAR to provide further information as to how it paid these non-Federal employee health insurance and retirement benefit expenses, and to amend its reports accordingly.

#### **IV. USE OF PAYROLL ACCOUNT FOR OTHER COMMITTEES' PAYROLL (Finding 1)**

Finally, we note that the proposed IAR indicates that the MDFLP processed the payroll for two Federal candidate committees. The auditors explained to staff that the candidate committees transferred funds to cover their payroll expenses to MDFLP's Federal account. The MDFLP then transferred the salary payments it received from the candidate committees to its own payroll account and then disbursed the salary payments on behalf of the candidate committees. The auditors indicated that both the candidate committees and the MDFLP properly disclosed the salary-related transfers and disbursements. The auditors also explained that they examined the transactions to determine whether funds from the candidate committees subsidized MDFLP's Federal payroll and concluded that they did not. Nonetheless, we recommend that the auditors modify the proposed IAR to explain in detail the MDFLP's activity in processing the payroll for other committees and its conclusion that the activity was permissible.